

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B3

PLR-107693-20

Date:

September 17, 2020

Legend:

X =

Y =

Z =

A =

B =

Trust =

Trust 1 =

Trust 2 =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

n =

Dear :

This letter responds to your letter dated March 10, 2020, and subsequent correspondence, submitted on behalf of X, requesting a ruling under §1362(f) of the Internal Revenue Code.

Facts

The information submitted states that X was incorporated under the laws of State on Date 1. X elected to be an S corporation effective Date 2. X, as the parent S corporation, filed Form 8869, Qualified Subchapter S Subsidiary Election, intending for Y and Z to be treated as qualified subchapter S subsidiaries ("QSubs") effective Date 2.

Shares of X were owned by Trust which X represents was a grantor trust described in §1361(c)(2)(A)(i) of which A and B were deemed owners. On Date 3 A died, causing Trust to cease being a grantor trust as to A's share. Under §1361(c)(2)(A)(ii), Trust remained an eligible shareholder as to A's share until Date 4, two years after A's death.

The terms of the Trust agreement provide that upon the death of A, the assets of Trust were to be distributed to Trust 1 and Trust 2. X represents that Trust 1 qualified as a wholly-owned grantor trust with respect to B under § 677(a), which is an eligible S corporation shareholder under § 1361(c)(2)(A)(i). X also represents that Trust 2 was qualified to be an Electing Small Business Trust (ESBT), within the meaning of § 1361(e), however, the trustee of Trust 2 failed to make an election under § 1361(e)(3) to treat Trust 2 as an ESBT. Consequently, Trust 2 was an ineligible shareholder, and, as a result, X's S corporation election terminated on Date 5, which also caused the termination of the QSub elections of Y and Z on Date 5.

X represents that there was no tax avoidance or retroactive tax planning involved in the failure of Trust to distribute shares of X stock to eligible shareholders on or before Date 4 or in the failure of Trust 2 to file an ESBT election. X and its shareholders agree to make any adjustments consistent with the treatment of X as an S corporation, and Y and Z as QSubs, as may be required by the Secretary

Law and Analysis

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under §1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that the term “small business corporation” means a domestic corporation that is not an ineligible corporation and which does not, among other requirements, have as a shareholder a person (other than an estate, a trust described in §1361(c)(2), or an organization described in §1361(c)(6)) who is not an individual.

Section 1361(b)(3)(A) provides that, except as provided in regulations prescribed by the Secretary, for purposes of this title (i) a corporation which is a qualified subchapter S subsidiary shall not be treated as a separate corporation, and (ii) all assets, liabilities, and items of income, deduction, and credit of a qualified subchapter S subsidiary shall be treated as assets, liabilities, and such items (as the case may be) of the S corporation.

Section 1361(b)(3)(B) provides that, for purposes of § 1361(b)(3)(B), the term “qualified subchapter S subsidiary” means any domestic corporation which is not an ineligible corporation (as defined in § 1361(b)(2)) if (i) 100 percent of the stock of such corporation is held by the S corporation, and (ii) the S corporation elects to treat such corporation as a qualified subchapter S subsidiary.

Section 1361(c)(2)(A)(i) provides that, for purposes of §1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States may be a shareholder.

Section 1361(c)(2)(A)(ii) provides that for purposes of §1361(b)(1)(B), a trust which was described in §1361(c)(2)(A)(i) immediately before the death of the deemed owner and which continues in existence after such death, is a permitted shareholder, but only for the 2-year period beginning on the day of the deemed owner’s death.

Section 1361(c)(2)(A)(v) provides that for purposes of § 1361(b)(1)(B), an electing small business trust is a permissible shareholder.

Section 1361(e)(1)(A) provides that, for purposes of § 1361, except as provided in § 1361(e)(1)(B), the term “electing small business trust” means any trust if (i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in § 170(c)(2)-(5), or (IV) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary, (ii) no interest in such trust was acquired by purchase, and (iii) an election under § 1361(e) applies to such trust.

Section 1361(e)(3) provides that an election under § 1361(e) shall be made by the trustee. Any such election shall apply to the taxable year of the trust for which made and subsequent taxable years of such trust unless revoked with the consent of the Secretary.

Section 1.1361-1(m)(2)(i) of the Income Tax Regulations provides, in part, that the trustee of an ESBT must make the ESBT election by signing and filing, with the service center for which the S corporation files its income tax return, a statement that meets the requirements of § 1.1361-1(m)(2)(ii).

Section 1.1361-1(m)(2)(iii) provides that the ESBT election must be filing within the time requirements prescribed in § 1.1361-1(j)(6)(iii) for filing a qualified subchapter S trust (QSST) election.

Section 1.1361-3(a)(1) provides that the corporation for which the QSub election is made must meet all the requirements of § 1361(b)(3)(B) at the time the election is made and for all periods for which the election is to be effective.

Section 1362(a) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1362(d)(2)(A) provides that an election under §1362(a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(d)(2)(B) provides that any termination under §1362(d)(2)(A) is effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under §1362(a) by any corporation was terminated under §1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in termination, steps were taken so that the corporation for which the termination occurred is a small business corporation; and (4) the corporation for which the termination occurred, and each person who was a shareholder of the corporation at any time during the period specified pursuant to §1362(f), agree to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to this period, then, notwithstanding the circumstances resulting in termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Conclusion

Based solely on the facts submitted and representations made, we conclude that X's S corporation election, and Y and Z's QSub elections, were terminated on Date 5 when Trust 2 became an ineligible shareholder. We also conclude that the terminations were inadvertent within the meaning of §1362(f). Consequently, we conclude that X will

continue to be treated as an S corporation from Date 5 and thereafter, provided that X's S corporation election was valid and was not otherwise terminated under §1362(d). In addition, we conclude that Y and Z will continue to be treated as QSubs from Date 5 and thereafter, provided that Y and Z's QSub elections were not otherwise terminated under § 1362(b)(3)(B).

This ruling is subject to the following conditions: (1) as an adjustment under § 1362(f)(4), a payment of \$n and a copy of this letter must be sent to the following address within 45 days from the date of this letter: Internal Revenue Service, Kansas City Submission Processing Campus, 333 W. Pershing Road, Kansas City, MO 64108, Stop 7777, Attn: Manual Deposit; and (2) within 120 days from the date of this letter, the trustee of Trust 2 must file an election to treat Trust 2 as an ESBT effective Date 5 with the appropriate service center. A copy of this letter should be attached to the ESBT election. If these conditions are not met, then this ruling is null and void. Furthermore, if these conditions are not met, X must send notification that its S corporation election has terminated to the service center with which X's S election is filed.

Except for the specific ruling above, no opinion is expressed or implied concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, no opinion is expressed or implied on whether X is otherwise eligible to be an S corporation, whether Trust 2 qualifies as an ESBT, or whether Y and Z qualify as QSubs.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the ruling request, it is subject to verification on examination.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Under a power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Sincerely,

Adrienne M. Mikolashek
Chief, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2):

Copy of this letter

Copy for §6110 purposes

cc: